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C O N F I D E N T I A L SECTION 01 OF 02 KYIV 000113

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DEPT FOR EUR, EUR/UMB

E.O. 12958: DECL: 01/24/2020
TAGS: EFIN ETRD PGOV PINR PREL UP XH EREL
SUBJECT: WORLD BANK PROPOSES UKRAINE REFORM PROGRAM

REF: KYIV 103

Classified By: Ambassador John F. Tefft for Reasons 1.4 (b) and (d)

¶1. (C) Summary. The World Bank's Kyiv-based country director Martin Raiser plans to convene the donor community to coordinate a message to Ukraine's new President on needed economic reforms. Raiser told the Ambassador that the Bank had grouped its reform proposals into three areas (fiscal, investment climate, financial sector), and that the World Bank had already outlined specific suggestions for programs that could be immediately enacted. Raiser noted World Bank President Zoellick had requested frequent Ukraine briefs and would consider visiting Kyiv once it was clear that Ukraine was making efforts at economic reform. Separately, Raiser noted his concerns with the IMF's optimistic plans for re-engaging Ukrainian authorities, suggesting the Fund could face serious pressures to disburse a fourth tranche before post-election political consolidation had been fully completed. End summary.

WORLD BANK TO COORDINATE REFORM PUSH

¶2. (C) World Bank country director Martin Raiser told the Ambassador on January 21 that the Bank would bring together donors from the international community in the coming weeks to frame a reform plan for Ukraine's incoming President. The World Bank wanted to gather all multi- and bilateral stakeholders, so that each could not only express priority concerns but also agree on common talking points. Raiser felt it was essential for the donor community to speak in one voice to the new Ukrainian authorities, since vested political and business interests might push against donor goals. Raiser also emphasized it was essential for the Bank to show it could make progress with the new administration to justify continued broad engagement.

PRIORITY REFORM AREAS

¶3. (C) Raiser grouped needed economic reforms into three areas: fiscal, investment climate, and financial sector. He noted that fiscal reforms would be the foundation for Ukraine's future economic growth. He explained that budget disparities needed to be addressed for Ukraine to get back on track with the IMF, which in turn would attract investment and stimulate the financial sector. Raiser said pension reform, energy price increases, and reductions in industrial subsidies were key austerity measures World Bank experts had already identified. On the issue of energy price increases, Raiser noted that then-Acting Prime Minister Yekhanurov raised gas prices in 2006 and there had been no public protests against the move. In his opinion, gas prices could again be raised without political fallout since energy bills

were a small percentage of total household expenditures.

¶4. (C) Among his suggestions for investment climate improvements, Raiser indicated deregulation and tax reform as the most essential first steps. He said Ukraine could only increase its competitiveness if it reduced redundant regulation and streamlined taxation. Longer term anti-corruption work with the judiciary and administrative organs was also necessary but would be more politically difficult and thus needed to come later. Corruption in public procurement was a persistent drag on Ukraine's economy, since 20% of Ukraine's GDP is derived from state purchasing.

¶5. (C) Raiser said the most pressing financial sector problem remained inadequate capitalization levels within Ukraine's banking system. Separately, Raiser insinuated to Econoff that a new round of bank stress testing was needed, especially for first and second tier domestic banks.

POSSIBLE ZOELLICK VISIT

¶6. (C) World Bank President Zoellick had considered coming to Ukraine in 2009 to encourage reforms announced for Ukraine's gas transit system. However, with the onset of the economic crisis and growing evidence that Prime Minister Tymoshenko was unlikely to implement her promises, the World Bank called off the visit. World Bank management was now mulling over a 2010 visit by Zoellick, but only after the donor community and the GOU had built and begun to implement a reform agenda.

WORLD BANK CONCERNED ABOUT IMF OPTIMISM

¶7. (C) Separately, Raiser noted to Econoff that he was concerned about the IMF's "best and only case scenario" for re-engaging Ukraine after the presidential election. The Fund recognized Ukraine's fiscal situation was critical, and that IMF lending would be necessary to prevent a damaging budget crisis in the first quarter. Nonetheless, Raiser agreed that the IMF seemed to have done too little planning for possible delays, either due to court litigation or other post-election uncertainty, that could push back the formation of a new government and the IMF mission team's visit.

¶8. (C) Raiser felt that the IMF would run into serious reputational risks if it disbursed without a clear winner in the presidential election and a newly formed government. On the other hand, Raiser warned that asset prices would likely plunge in March if the IMF signaled it had to delay its re-entry. He raised the concern that Kremlin-backed Russian investors were watching and waiting for the opportunity to pick up distressed assets, while Russian banks expected they would have increased leverage over corporate borrowers and sovereign Ukraine for which there would be no other lending source.

COMMENT

¶9. (C) The World Bank has vacillated in its commitment to donor coordination over the last year, mostly due to the political paralysis that inhibited new lending programs from being initiated. Its new drive to take charge of a reform program is encouraging and would benefit from ongoing USG input. A more disheartening note was struck by Raiser over the IMF program, tracking with our concerns following a January 20 meeting with the IMF's Kyiv-based resident representative (reftel).

TEFFT